

**Joint Legislative Audit and Review Commission  
of the Virginia General Assembly**



**VRS Oversight:  
VRS Semi-Annual Investment Report:  
December 2002**

**JLARC Staff Briefing  
December 16, 2002**

# VRS Oversight Act

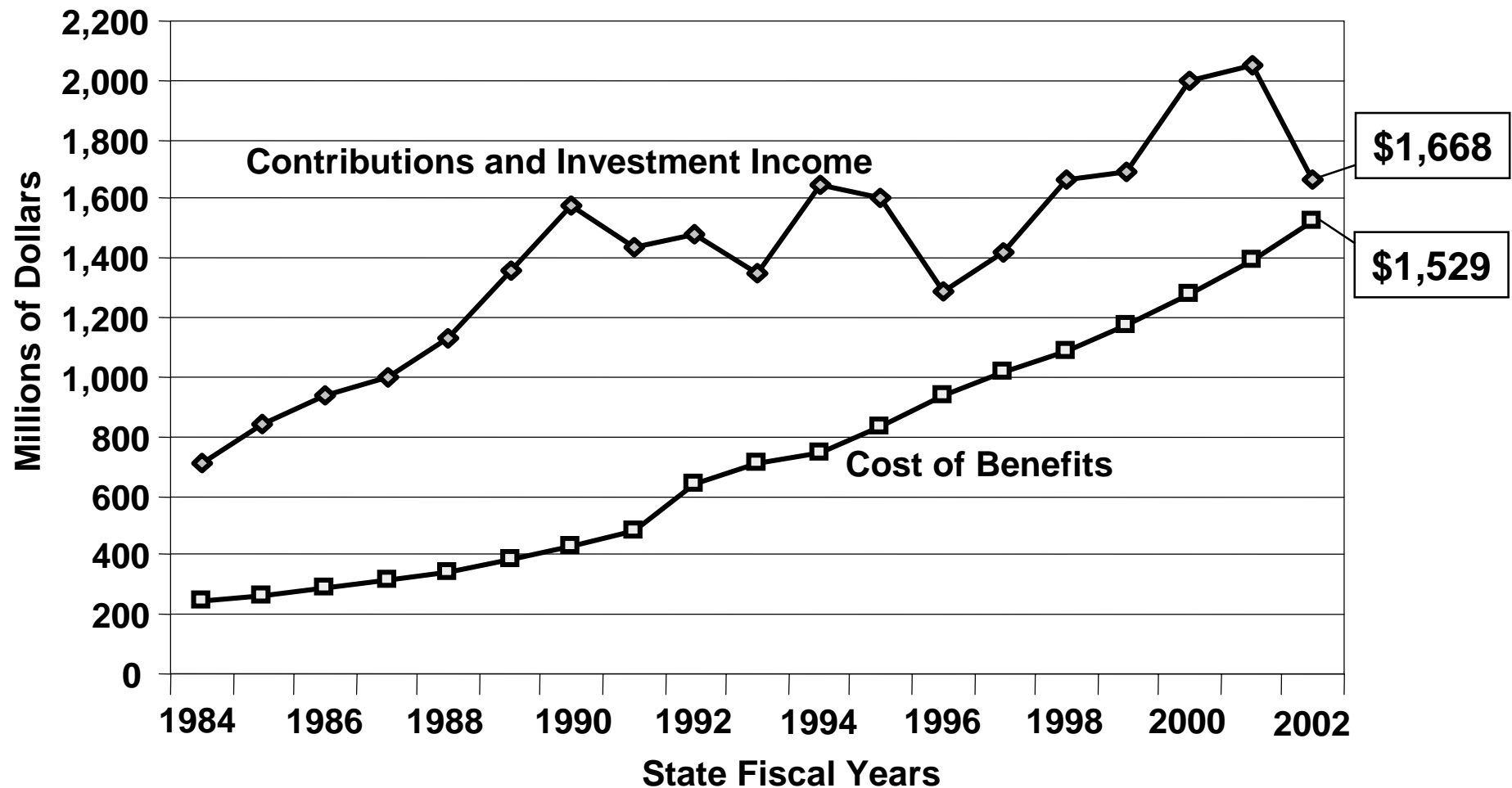
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- **Section 30-78 *et seq.* of the *Code of Virginia* requires JLARC to oversee and evaluate VRS on a continuing basis**
- **Areas for review and evaluation include:**
  - **Structure, governance, administration, and management**
    - **Biennial status report required**
  - **Actuarial policy and actuarial soundness**
  - **Investment practices, policies, and performance**
    - **Semi-annual investment report required**

# Contributions and Investment Income Versus the Cost of Benefits

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# Semi-Annual Investment Report

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- The market value of the fund's assets as of September 30, 2002, was \$30.8 billion
- VRS' investment returns for the one- three-, and five-year periods, -8.9, -3.4, and 2.0 percent respectively, fell short of the current actuarial assumed investment return of eight percent
- At 8.2 percent, the total fund's investment return for the 10-year period ending September 30, 2002, slightly outperformed its benchmark (7.9 percent) and the current actuarial assumed rate of return

# **Semi-Annual Investment Report**

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- **As public equity comprises 58.4 percent of the total portfolio, the conditions in the public equity market continued to negatively impact the fund's overall investment performance**
- **U.S. and non-U.S. equities reported negative returns for the fiscal-year-to-date, one-, and three-year periods ending September 30, 2002. Non-U.S. equities also had negative returns for the five-year period and failed to meet its benchmark over all of these periods**
- **The fixed income, real estate, and high yield programs outperformed U.S. public equities, offered necessary fund diversification, and provided positive returns for the one-year period ending September 30, 2002**
  - **Fixed income                      7.8 percent**
  - **Real estate                        7.7 percent**
  - **High yield                         1.9 percent**

# **Semi-Annual Investment Report**

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- While the return for high yield bonds was 1.9 percent for the period ending September 30, 2002, the portfolio has suffered recent declines with fiscal year-to-date returns of -2.7 percent. During the same period, however, returns for the Russell 3000 were -17.2 percent
- Largely due to the performance of corporate bonds, the fixed income program has lagged behind its benchmark for the fiscal-year-to-date, one-, three-, and five-year periods
- As one-fifth of all start-ups that received venture capital funding during 1999 and 2000 have already closed or filed for bankruptcy, returns for private equity will likely not be as robust as those achieved in 1999 and 2000
- Strong positive returns previously provided by the real estate program have recently turned negative

# **Board Approves Inclusion of New Asset Class**

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- **The Investment Advisory Committee recommended and the Board approved the inclusion of a hedge fund program in the alternative investment category**
- **The Board approved an initial allocation of up to \$500 million to the hedge fund program with three initial strategies:**
  - **long-short equity market neutral**
  - **long-short hedged equity**
  - **distressed**
- **Hedge funds are relatively liquid compared to other asset classes, but fees are higher and performance-based**
- **Target date for implementation is March 2003**

# Asset-Liability Analysis Underway

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- The investment department at VRS is beginning an asset-liability analysis with the fund's actuary to be completed by February 2003
- Study objectives include:
  - Testing the potential risk and return outcomes of various asset combinations
  - Assessing the impact of various portfolio structures on contribution rates
  - Measuring volatility in contribution rates and funded status
- An asset-liability analysis assists VRS in developing its asset allocation plan, a key factor impacting the long-term investment performance at VRS



# Corporate Governance Task Force Established

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- In response to concerns about financial misstatements by firms, accounting fraud, and other corporate governance issues, the VRS Board established a Corporate Governance Task Force
- W. Mark Crain, Ph.D., member of the VRS Board and economics professor at George Mason University, chairs the Task Force
- Other members of the Task Force are:
  - Norwood Jackson, accountant and former state auditor
  - Ruffin King, lawyer and retired investment manager
  - Steven A. Markel, insurance executive
  - Owen Pickett, attorney and former member of Congress
  - Paul W. Timmreck, VRS Board member and Senior Vice President at Virginia Commonwealth University

# **Corporate Governance Task Force**

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- **The task force will review current VRS practices designed to protect assets and to examine methods of gaining greater accountability from publicly traded companies**
  
- **Specifically the task force will:**
  - **Examine the role of public pension fund as shareholder**
  - **Compile and review academic research and best practices employed by peer pension funds**
  - **Assess the impact of several remedies proposed by Congress and the stock exchanges**
  - **Issue a corporate governance policy statement and recommendation to the VRS Board of Trustees by February 2003**

# Membership Changes in the Investment Advisory Committee

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- VRS Board of Trustees named Raymond D. Smoot, Jr., Ph.D, as chairman and Joseph Grills as vice chairman of the Investment Advisory Committee (IAC)
- Alice Handy and Deborah Allen Hewitt were also appointed to the IAC